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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 834

LA SOCIETE FRANCAISE DE BIENFAISANCE MUTUELLE, A CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 29–55) is reported in 57 F. Supp. 201. The opinion of the Circuit Court of Appeals (R. 196–205) is reported in 152 F. 2d 243.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 3, 1945. (R. 205–206.) The petition for a writ of certiorari was filed on February 11, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether taxpayer was exempt from social security taxes as a corporation organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual within the meaning of Sections 811 (b) (8) and 907 (c) (7) of the Social Security Act and the corresponding provisions of the Internal Revenue Code?

2. Whether the Commissioner was estopped from asserting taxpayer's true social security tax liability because of his prior erroneous ruling that taxpayer was exempt from such taxes?

STATUTES AND REGULATIONS INVOLVED

The pertinent statutory and regulatory provisions are set forth in the Appendix, *infra*, pp. 13–18.

STATEMENT

The facts as found by the District Court may be summarized as follows:

Taxpayer operates a large general hospital in San Francisco, which admits the general public, as well as it own members, a school for nurses, and a home for aged members. (R. 30, 38, 41, 42, 44). It was incorporated in 1856, under Chapter VIII (relating to "Religious and other Associations or Societies") of the California Corporation Act of 1850. It succeeded an unincorporated beneficial society of the same name which had

been founded in 1851. Its sole purpose has always been the care and treatment of the sick without profit, being founded on the basis of mutuality for the treatment of sick members. (R. 38, 119.) Taxpayer's affairs have been managed by a board of directors, elected annually by the members of the society, who serve without compensation. Taxpayer has never had any capital stock, has never paid dividends or other distributions to any one, and no part of its net earnings has ever inured to the benefit of any private shareholder or individual. (R. 38–39.)[1]

Membership in taxpayer is limited to those of French birth or descent, or to the members of their immediate families or to those who speak French. (R. 30.) The number of members is not limited, and has averaged around 9,700 during the taxable periods here involved. Taxpayer never solicits members and has never paid any commission to obtain new members. Members pay an admission fee and monthly dues of $1.75 except children who pay dues of $1 and life members who pay a flat sum of $1,500, and in return receive medical treatment and hospital care gratuitously, or at less than the normal cost charged nonmember paying patients admitted to the hospital. (R. 30, 43–45.) Only members in good standing re-

[1] The Circuit Court of Appeals concluded, however, that profits may inure to the benefit of a private shareholder other than by monetary dividend payments and that they did so in the instant case. (R. 201–202.)

ceive these privileges and if a member is six months in arrears in his dues he loses his privileges (R. 122, 197), although continued payment of dues is not necessarily a condition to relief for indigent or other needy members and their families who may be treated free of charge at the discretion of the board of directors (R. 43).

From 1937 to and including 1942, approximately 40 percent of taxpayer's gross income was derived from fees paid by nonmembers for hospitalization while 55 percent consisted of members' monthly dues and admissions and reduced fees charged members for hospitalization. The balance was received from dividends, interest and rent on investments owned by taxpayer, miscellaneous sources, and gifts and bequests to it. (R. 45, 154, 198.) Since 1851, legacies, devises and gifts have aggregated over $360,000. Taxpayer acquired its present plant and facilities mainly through testamentary and other gifts. Receipts from members would not have been sufficient therefor. (R. 39.) During the years in question, gifts and bequests have amounted to less than one percent of taxpayer's annual gross income. (R. 154, 199.)

The hospital is approved by the American Medical Association and American College of Surgeons as a "Class A" hospital and accredited for the training of interns of whom there are usually six. (R. 40, 41.) It has a capacity of

225 beds and 15 nursery cribs. (R. 40.) Of the 225 beds it provides two permanent free beds for the treatment of indigent persons under the patronage of the French Ladies Relief Society, and maintains from current income an Old People's Home, with a capacity of 15 beds, for the care of aged and feeble members who are admitted at the discretion of the board of directors and pay according to their ability, but not upon fixed schedules or any profit making basis. (R. 42.) A nurses' training school, with a building built and used exclusively as a training home, is also maintained at an annual cost of about $12,000. Usually 60 or 70 nurses are in training. (R. 41.)

For the eight years prior to 1944, consultations by members at, or calls on members by the medical staff outside, the hospital averaged 26,987 annually. (R. 41.) Free emergency treatment to all deserving cases in the neighborhood consisted on an average of 300 annually, or about 1.1 percent of the members treated. (R. 42–43.)

Any surplus from taxpayer's operations is invested in the hospital plant or held in reserve for that purpose and the members have no interest in the hospital plant and other assets of the society other than the right to use its facilities. (R. 30, 32.)

There has been no change in taxpayer's plan of operations since many years prior to 1936. On July 14, 1937, the then Deputy Commissioner of

Internal Revenue officially notified taxpayer that it was exempt from payment of taxes imposed by the Social Security Act inasmuch as it came within the exception provided in Section 811 (b) (8) of Title VIII and Section 907 (c) (7) of Title IX, and further that it was entitled to exemption under the provisions of Section 101 (6) of the Revenue Act of 1936. (R. 45.) On February 24, 1939, the then acting Commissioner of Internal Revenue notified taxpayer that while it appeared that the corporation was not operated for profit and did engage in substantial charitable activities, it was nevertheless not entitled to exemption from income taxes under the provisions of Section 101 (6) of the Revenue Act of 1938 as a corporation organized and operated exclusively for charitable purposes, and that the ruling contained in the Bureau letter dated July 14, 1937, was modified accordingly. (R. 45–46.) Thereafter on April 3, 1939, the Deputy Commissioner of Internal Revenue notified taxpayer, referring to the communication of February 24, 1939, that it was not entitled to exemption under Section 811 (b) (8) of Title VIII and Section 907 (c) (7) of Title IX of the Social Security Act. (R. 46.)

After receipt of the Bureau ruling of July 14, 1937, taxpayer refunded to its employees all the contributions which theretofore had been deducted from their wages and made no further deductions

until the ruling was reversed by the letter dated April 3, 1939. Taxes, penalties and interest later paid for that interval were paid exclusively from taxpayer's funds without any deductions from employees' wages, nor was taxpayer ever repaid by any employee in whole or in part. (R. 46.)

The findings then set forth the amounts and dates of payments of social security taxes, penalties and interest involved in the action. The aggregate amount paid was $35,269.85. (R. 47–50.) After claims for refund were filed and disallowed, taxpayer instituted the present action. (R. 51–54.)

The District Court concluded that taxpayer since August 14, 1935, the effective date of the Social Security Act, was a charitable corporation within the meaning of Section 811 (b) (8) of Title VIII and Section 907 (c) (7) of Title IX of the Act and corresponding sections of the Internal Revenue Code, and that taxpayer was entitled to judgment for the $35,269.85 taxes, penalties and interest paid, with interest from the dates of payment and its costs of suit. (R. 54–55.)

The Circuit Court of Appeals, however, reversed the judgment of the District Court and held that taxpayer was not a corporation organized and operated exclusively for charitable purposes, was not exempt from payment of social security taxes, and was not entitled to recover

any of the taxes, interest, and penalties sought, including those amounts paid on behalf of its employees for the period in which it failed to collect the taxes or returned them to the employees under the mistaken view that the original ruling of the Commissioner was correct. (R. 203–205.)

ARGUMENT

1. The decision below specifically follows the ruling of this Court in *Better Business Bureau of Washington, D. C., Inc.* v. *United States,* decided November 13, 1945, No. 52, this Term. (Cf. Pet. Br. 23–26.) Hospital treatment of nonmembers at more than cost clearly was not charitable in nature. This was one of taxpayer's most substantial activities and because of it, under the rule of the *Better Business Bureau* case, the taxpayer was not entitled to the exemption sought. Moreover, the stated purpose for which taxpayer was organized and operated, namely, to supply better and cheaper hospital benefits to its dues paying members, is fundamentally a form of group health or mutual benefit insurance and not within the scope of the exemption provision. *Hassett* v. *Associated Hospital Service Corp.,* 125 F. 2d 611 (C. C. A. 1st), certiorari denied, 316 U. S. 672. To supply hospital treatment to a class of persons may of course be a charitable pursuit under certain circumstances. But there is no reason to conclude that a cooperative hospital is any more a charity

than any other form of cooperative enterprise which enables its members to benefit financially from the mutual association. Moreover, when we consider along with this noncharitable purpose the further fact that the profits made on serving outsiders were used to lower the cost of hospital and medical treatment to the members, we have, as the court below held, violation of the additional exemption requirement that the net earnings must not inure to the benefit of private individuals.

It is claimed, however, that this reasoning conflicts with the holding of this Court in *Trinidad* v. *Sagrada Orden,* 263 U. S. 578, in that it ignores the use to which the funds are put, while erroneously emphasizing their source. But in the *Sagrada Orden* case, dividends, interest, rents, and profits on small sales of wine and chocolates were admittedly directed solely to the institution's religious, charitable and educational pursuits. Here the excess over cost of the fees charged nonmembers was not allocated solely to charitable purposes but was used to lower the cost of treatment for members who scarcely could be classified as, or would consider themselves to be, the recipients of charity. This likewise differentiates the instant case from *Koon Kreek Klub* v. *Thomas,* 108 F. 2d 616 (C. C. A. 5th); *Santee Club* v. *White,* 87 F. 2d 5 (C. C. A. 1st); *Scofield* v. *Corpus Christi Golf & Country Club,* 127 F. 2d 452 (C. C. A.

5th); *Commissioner* v. *Kensico Cemetery*, 96 F. 2d 594 (C. C. A. 2d); *Roche's Beach, Inc.* v. *Commissioner*, 96 F. 2d 776 (C. C. A. 2d); *United States* v. *Proprietors of Social Law Library*, 102 F. 2d 481 (C. C. A. 1st); and *District of Columbia* v. *Mt. Vernon Seminary*, 100 F. 2d 116 (App. D. C.); all alleged to be in conflict (Pet. Br. 30–32), where the income was used only to further the ends which were made the original basis of the exemption.

Taxpayer also contends (Br. 15–23) that the legislative history of the Social Security Act reveals that the mere fact that a hospital is not operated for profit entitles it to the exemption. This is plainly in error, since the emphasis is not upon the nonprofit aspect, but upon the use to which the profits are put. *Trinidad* v. *Sagrada Orden*, *supra*. Obviously, Congress intended to and did exempt the typical hospital, where the fees charged usually are to defray merely part of the cost of service, and whatever profits may be derived from paying patients are allocated together with gifts, bequests, and grants which form not one percent as here but a substantial part of gross income, to the free treatment of the poor. It is this typical hospital which is referred to in the opinion of the Attorney General holding that a nonprofit hospital was exempt. (40 Op. A. G. No. 72 (1943).) The opinion did not relate the exemption to an organization in the nature of a

mutual benefit association where profits derived from nonmembers inured to the private benefit of the members.

Finally, it should be noted that for purposes of the California Unemployment Insurance Act (Statutes of 1935, c. 352, as amended) enacted in co-ordination with Title IX of the Social Security Act, taxpayer has been held to be outside the exemption granted to charitable corporations in virtually the identical language as that used in the federal statute (*La Societe Francaise* v. *Cal. Emp. Com.* 56 Cal. App. 2d 534). The same arguments as those now advanced were relied on in a petition for certiorari filed by taxpayer in that case which was denied. (320 U. S. 736.)

2. The rule is well established by this and the Circuit Courts of Appeals that within the statute of limitations the Commissioner may reverse an erroneous opinion or ruling and assert the taxpayer's true tax liability. *Burnet* v. *Porter,* 283 U. S. 230; *Sweets Co. of America* v. *Commissioner,* 40 F. 2d 436 (C. C. A. 2d); *Knapp-Monarch Co.* v. *Commissioner,* 139 F. 2d 863 (C. C. A. 8th); *Stanford University Book Store* v. *Helvering,* 83 F. 2d 710 (App. D. C.). No conflict in decisions is alleged. (Pet. Br. 33–37.)

CONCLUSION

The decision below is correct and there exists no conflict in decisions or other occasion for further

review. The petition should therefore be denied.

Respectfully submitted

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MARCH, 1946.